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20 JAN 1960

MEMORANDUM FOR: Comptroller

SUBJECT : Report on the Current Status and
Problems of the Fiscal Year 1960
Financial Management Program

The conference that we held in May 1959 dealt with financial management in the Agency with particular emphasis on the program for fiscal year 1960. I feel it is now appropriate to report on the current status and problems of this program.

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The program originally outlined for fiscal year 1960 encompassed:

- a. The introduction to cost based budgets by requiring the submission of fiscal year 1960 operating budgets on a cost basis for a limited number of indirect cost items;
- b. A proposal to completely decentralize the allotment control system whereby the detailed obligation records for vouchered funds as well as unvouchered funds would be maintained by the offices;
- c. The addition of accrued costing to our cost accounting system;
- d. A revision of the financial code structure with the objective of furnishing as much financial data as possible to serve the requirements of management; and

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- e. An improved reporting structure to provide better data in a more useful form concerning the status of obligational and cost authorities.

In addition to these items, various members of the staff have been working on other aspects of the program such as financial training, property control, procurement planning and funding, procedures, and financial policies for fiscal year 1961. The entire program is geared to our general theme of providing "Better Financial Data for Better Decisions."

ACCOUNTING SYSTEM

Accrued Costing:

In accordance with Public Law 863 we have implemented our accrual and cost accounting system. We are mainly interested in costs to satisfy two requirements for historical cost data. First, we need the information in order to prepare cost based budgets and second as directed by Public Law 863, cost information must be furnished Management on a current basis so that Management can use the cost data in the control of activities. The two important uses of cost data for internal management purposes involves^{first,} the direct costs incurred in the conduct of an office's operations, that is, its own salaries, travel, and any other item over which the Office has direct control of the cost. The second is a more involved category which we have termed indirect cost, and covers items of common services such as property, printing, and books and publications which are

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being costed to consumers this year. The growing costs of these common services has been of increasing concern to the higher levels of management in this Agency. It has generally been believed that one of the reasons for the ever increasing costs of such services is due to the fact that the consuming office is not aware of what these services cost. To create a greater cost consciousness on the part of the consumer it has become Agency policy to charge the consumer for the common services over which he has control for placing orders. It should not be the policy of the Agency to charge all indirect costs to the consumer especially those indirect costs over which the consumer has no control and which mainly are created as a result of legal requirements, for example accounting and auditing services. Nevertheless in order that all services, whether controllable by the consumer or not, are subjected to Management review and evaluation and the costs of such services be kept within reasonable bounds, an accounting system must be established to accumulate the costs of such services.

We have been recording actual costs for several years. In order to refine and improve the system we are now in the process of adding accrued costs. Accrued costs are those items which we know or estimate to have been incurred but as of the date of accrual have not been recorded in the accounting office. The attempt is to give the most factual picture feasible as of the end of the reporting period in order that Management may have the best information possible

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on which to base decisions. We are experimenting with accruing costs, and have prepared reports for internal use reflecting the results of accumulating such cost data. These reports are being analyzed for shortcomings and weaknesses so that we may develop a good accounting and reporting system.

Property Accounting:

An important part of our accounting system is the financial control of property. By the end of this fiscal year we will have completed the installation of accounting procedures for the financial control of personal property throughout the Agency. Real property is the next area to be brought under financial control. The Office of Logistics and our Office are currently cooperating on the preparation of an experimental procedure for real property. Involved are such items as definitions of terms like property owned, property leased, and the determination of what property should be accounted for under financial control procedures. It is contemplated that the procedures will be installed on an experimental basis some time during fiscal year 1981.

Financial Coding:

One of the objectives of our accounting system is the development of a financial code structure that will enable the Agency to accumulate in an economical manner financial data to serve the various legal, budget, and management requirements. The over-all trend in the budget and accounting field is

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that of requiring more information. Our only hope in being able to meet such demands in an efficient and economical manner is to record this data at the time the original documents flow through the accounting offices. This is accomplished through the use of a financial code. We are not desirous of having people code documents just for the benefit of the Comptroller's Office but rather to provide a service to all by accumulating various detailed data that can be reported in summary and detail when required to serve the various needs for information. We know what is generally required for budget and legal purposes. We do not know completely what the managers of the various offices want in the way of financial data. We are experimenting with a new code this year. It is not being utilized to the full extent we feel it can be utilized. It is essential that this problem be given serious thought and that it be discussed in the offices so that we can fully utilize financial coding capabilities of our new management accounting system beginning with fiscal year 1961.

Valid Obligations:

Another aspect of improving our accounting data deals with the validity of obligations. We are aware of the legal requirements concerning what constitutes a valid obligation. Comptroller Instruction No. 79 was issued to remind budget and fiscal personnel of the legal requirements and to point out that beginning with the budget for fiscal year 1961

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it was necessary for the Agency to certify that all the obligations reported in that budget for fiscal year 1959 were valid in accordance with law. In order that such a certification can be made obligations recorded will be audited beginning with fiscal year 1959.

Procedures:

The last point that I wish to mention in connection with our accounting system concerns procedures. The procedures issued by the Office of the Comptroller are designed to help all in accumulating the financial data required to meet the various demands. We hope to accomplish this by giving a better understanding of why the procedure is necessary and things are done the way they are and secondly by providing the easiest way possible under the circumstances. We are aware of the fact that our procedures are not always clear and also that they are not interpreted in the same manner by all offices. It has always been the desire of this Office to periodically visit with budget and fiscal people and to review the manner in which procedures are applied. We have not always been able to follow through with this desire. During the experimental stages of an expanding accounting program, trying new methods, new forms, and installing new procedures, we feel more than ever the necessity of working closer with the offices in order that we develop the best program possible. We will attempt to visit the offices more often to review the interpretation and application of accounting procedures.

RCA 501

Our accounting system is rapidly growing to meet legal requirements. The changes that we are making in the system are designed to provide more information faster. One of the innovations that we are making is the installation of a computer system. By using the RCA 501 system we have opened to ourselves unlimited possibilities for the collection and summarization of financial data. To immediately achieve these possibilities is an impossible task. The secret to eliminating much of the time consuming operations in the processing of data lies in the development of good programs for the computer. The development of such programs requires much painstaking study, analysis and evaluation of what is wanted and the development of a set of detailed steps to tell the machine how to produce the desired information. Our immediate objective is to convert our present financial system to the computer. This we hope to achieve before the end of Fiscal Year 1960. Programmers have been and are working on this conversion and have stated that we have given them a tight time schedule. Another problem was the location of the computer. After much searching it has been determined to install it in Central building. We believe that after the initial conversion many new fields for the utilization of computer data will open to us. One utilization factor that we hope to achieve with the computer is assisting the offices in the development of various financial schedules. Many varied types of budget information

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are required to satisfy the Bureau of the Budget and the Congress. This has necessitated spending a large number of man-hours in preparing detailed budget schedules, which require review, evaluation, and written justification statements. In the past so much time has been consumed in the preparation of the schedules that very little time has been left for the preparation of good justification statements. It is hoped that the computer will be put to good use by having it prepare much of the actual detailed budget schedules leaving more time available for projection of budget requirements and the preparation of justification statements. The development of such a program for the preparation of budget schedules will require considerable time and effort. We desire to assign a person full time to study and resolve the problems that will be encountered in adapting machine methods to budget preparation. Because of the scope of the job it will be impossible to have such a system developed in time for the fiscal year 1962 budget, but I hope we can offer some relief in this budget preparation problem for the fiscal year 1963 budget.

BUDGETING

These are rather trying times that we are going through. We are engaged in the transition period between obligation type budgeting to cost-based budgeting. Experience has shown us that this transition must be gradual and at times rather painful. All of us are aware that before

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we can submit our cost budget externally we must experiment with it and secure reliable data internally. As a start in that direction we asked the offices to prepare an operating budget on a cost-basis for indirect cost items only for fiscal year 1960. These items are property, printing, and books and publications. There is no need for me to enumerate the many problems, both large and small, that we have already run into concerning the development of cost requirements and issuance of cost authority, keeping of the accounting records and making reports on these limitations. We hope to start studies on other indirect items such as translation and communications services. In addition, we are currently experimenting with the accumulation of direct cost data. We still have hopes of perfecting this data in sufficient time to request the offices to submit a full operating cost budget for fiscal year 1961. By full operating cost budget I mean direct costs as well as indirect costs. I wish to emphasize that whatever budget format and procedure is to be adopted for next fiscal year must be made available to the operating officials of the Agency by March 1960 in order that all will have ample opportunity to analyze and understand the requirements. I am strongly urging this course because we need agreement and support of the operating officials. Full understanding and cooperation are absolutely essential if we are to make any progress at all towards achieving the Agency objective of submitting a cost-based budget for fiscal year 1963 or 1964. Originally our objective was to submit a cost-based budget for fiscal year 1962.

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That objective is no longer possible and we have so informed the Bureau of the Budget in our latest report. The reason for this is that the actual data that would be used to prepare a cost-budget for fiscal year 1962 would be that for fiscal year 1960 which is the year in which we are now operating. I am sure that none of us would care to attempt a cost budget based on data which is still experimental and full of problems. We have even gone so far as to tell the Bureau of the Budget that we may not even be able to submit a budget for fiscal year 1963, the reason being that our fiscal year 1961 cost data which would be the basis for our fiscal year 1963 data would be incomplete and probably not conclusive enough on which to base a cost estimate. We have indicated that it would be more likely that we would submit a cost budget for fiscal year 1964. I feel we should not extend the deadline because the law passed in 1956 said that we would develop a cost-based budget as soon as practicable. Fiscal year 1961 could be meaningful and helpful towards achieving as early a submission of an Agency cost based budget as possible. These problems of the cost-based budget emphasize the trying and troublesome times that we are going through because while we are experimenting with cost budgeting internally and developing the basis for our external submission we still have to develop and submit our 1962 budget estimates for the Agency on an obligation basis.

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REPORTING

Another important aspect of our financial management program is the development of a cost reporting system. This system is being designed primarily to serve the offices in the preparation of cost budgets and in the furnishing of cost data for management control. The cost reporting system will be presented in two stages. The reports on indirect costs are already being furnished. We are now developing and reviewing the reports on the direct costs data. These reports will be presented to operating offices for review and evaluation at a later date. To be fully effective, the reports must be timely, as accurate as possible, and easy to read and understand.

DECENTRALIZED OBLIGATION CONTROL

The new cost accounting and budgeting systems ^{were} we added on to our present system -- not substituted for anything in the system. This means now we must have information concerning obligations, assets, liabilities, and costs, all of which must be recorded and accounted for within one integrated financial system. The natural reaction of any office, when additional work is placed on us is to ask for more personnel. We were told when the new financial management program was added that all requirements had to be met without any additional personnel. How do we perform more work without additional personnel? The best way that we could see at the time was to make sure that all duplicate

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~~duplicate~~ record keeping and informal record keeping were eliminated from the system. Last year we made an informal survey and found that most of the offices were keeping informal obligation records on their vouchered fund allotments. The Comptroller's Office was keeping the formal obligation record. Also we found in some instances that some offices were keeping records of data that could be provided them as a by-product of our machine accounting processes. We discussed at our May 1959 conference the proposal that the Comptroller undertake the maintenance of the cost system if the offices could assume responsibility for the formal obligation control records of vouchered funds. For most offices this merely meant placing informal records on a formal basis; however, at the conference and subsequent thereto, some offices expressed a great deal of concern over assuming this responsibility. We had originally proposed that the decentralized obligation control system of vouchered funds would go into effect last July 1 but because of the expressed concern we indefinitely delayed the implementation of the proposal and instead decided to experiment in a few offices to determine the amount of time and cost that would be involved in the maintenance of such formal obligation control records. While we were studying the effect of decentralization it was decided that the Agency would install the RCA 501 computer system. This system has unlimited possibilities, one of which we hope will be the maintenance of the formal obligation control records. This problem is currently being studied. If it

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is feasible to place the obligation control system on the new computer we will achieve our hope of being able to take on the additional cost accounting work without additional help and without burdening the offices. We hope that the results of our study will indicate that we can give obligation information on such a timely basis that those offices maintaining informal obligation control records will find it possible to discontinue some records and will therefore have more manpower for other financial activities.

TRAINING

The introduction of a program as far reaching as the cost system brings with it the responsibility to make sure that those having to deal with the program understand all of the new terminology, methods, and procedures. The success of the program will depend to a great extent on understanding the technical language and details. To help make the transition easily and rapidly and to have our new system become an effective management tool, we have installed as a permanent part of the management program the conduct of courses in budgeting and cost accounting. Although these courses may not be precisely what we are looking for, we are gradually developing them into a very useful training tool providing a better background of the philosophy and technical aspects of the cost system. We are encouraging all personnel engaged in budget and fiscal activities to take advantage of this training.

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OBJECT CLASS STUDY

In our study of the various demands for information, it was interesting to note how many of those demands related to specific objects of expenditure. These are the things that we buy with the money entrusted to us and not the purpose and end result for which these things are used. Practically all of the analyses that we make, whether the analysis is the cost of an activity or a project, or an office, gets into the specifics of the things used and the things used are reflected in object class data. Since this kind of data is basic to our budget and accounting processes we must have uniformity to the greatest extent possible throughout the Agency. This means that we must have available a single guide for all purposes. That is for the preparation of the budgets, for the processing of accounting documents, and for use in all localities. We cannot live with the approach of having budgets prepared on one object class basis and the accounting recorded on another object class basis. To assist in solving this problem, we have a study group reviewing the object class question. We anticipate issuing an object class guide early this year which will outline the philosophy of object class data, give the definitions of the various objects and sub-objects that will be used in this Agency and will give illustrations where it is believed that they will be helpful.

ALLOTMENTS

One of the requirements of Public Law 863 was that we

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should issue allotments at the highest practicable level in the organization in order to permit maximum flexibility in the use of funds and yet provide control over the use of those funds. Of course, as a reminder with this requirement was a directive that cost data should be used for lower level operational control purposes. We experimented with several methods leading towards a reduction in the number of allotments in the Agency. The result is that for 1960 we have fewer than 200 allotments in the Agency with the general pattern being one vouchered fund allotment and one unvouchered allotment for each office, staff and division. There are special allotments covering certain projects, releases from the reserve and the funding of activities that result in indirect cost, such as procurement, the printing, and books and publications. Occasionally we have discussed the hope that we could still further reduce the number of allotments by consolidating the vouchered and the confidential fund allotments. Although we may consider this approach a desirable objective, for reasons that you are well aware of, we have decided to ^{defer} keep indefinitely changing the present method of separate vouchered and confidential fund allotments.

PROCUREMENT PLANNING AND FUNDING

One of the most significant innovations in cost-based budgeting is what is called the resources section of the budget. Cost-based budgeting simply means that each

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organizational entity in the Government will determine what it costs on a current basis, that is, what items of goods and services does it expect to consume during the budgeted year. Then each Agency is expected to make an analysis of the resources that it has available to apply against those costs. Those resources generally consist of inventories on hand and expected deliveries of orders previously placed. After making a determination as to whether the balance of resources is to remain constant or to go up or down then the Agency will determine what obligating authority is needed to meet its costs and changes in resources. Now what does this mean to this Agency? Briefly, it means that we will have to reveal the amount of our inventories and the composition of them, we will have to indicate what are our undelivered orders and outline our procurement plans. It further means that we will make a disclosure of various funding problems such as pricing, lead-time procurement, obsolescence, and write-offs. While we are working with the offices concerning the development of cost requirements the technically cognizant offices for materiel and the Comptroller's Office have been working on this tremendously important resources section of the cost budget. The Budget Division is maintaining control records and is developing trend data that will be used in conjunction with the operating statistics of the technically cognizant offices. The Office of Logistics is working on a detailed issues listing which can be used for projection purposes.

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CLOSING

In closing I would like to point out two interesting observations concerning the financial management program throughout the Government and this Agency in particular. First, Public Law 863 and financial management apparently means cost-based budgeting to most people. There is a general feeling that cost-based budgeting is not fully understood by the public, most members of the Congress, and representatives of the Bureau of the Budget. Some appropriations sub-committees have expressed great reluctance to giving up the familiar obligation type budgets - they have even gone to the extent of having some agencies submit budgets on both bases. Consequently there appears to be a lot of "lip service" together with "footdragging" in anticipation that the legal requirement for cost-based budgets will be dropped. In fact this lagging behind has benefited many of us in that we have been able to avoid costly exercises that the Bureau of the Budget and the Congress have subsequently turned down for other agencies.

This attitude of hesitation gives rise to the second observation. There are many other aspects the Congress included in the financial management program (P.L. 863) - cost-based budgets is only one. Unfortunately the general impression and outlook on the entire program are colored by whatever happens to cost-based budgeting. This should not be the case. There are several aspects of the program

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required by P.L. 863 that we have either already adopted or propose to put into effect regardless of the cost-based budget outcome. Establishing allotment controls at the highest practicable level; resources planning, funding, and control; integrated financial property accountability; accrual accounting; cost information for management purposes; financial training; and improved reporting are some of the more important aspects that come to mind. Most of these things we should do from a good management standpoint even if we don't have a cost-based budget. It is my conclusion, after talking with other government agencies, that the Congress will retain these items even though it may moderate its position on cost-based budgets.

The point I wish to make clear is that the financial management program offers many opportunities for improving our approach to the problem of planning, coordinating and controlling the use of resources. Although cost-based budgeting is an important part of P.L. 863, it is at present the debatable part. The others are less controversial, just as effective and, in many cases, prerequisites to preparing cost-based budgets. We are moving ahead to install them as rapidly as possible. The progress of our financial management program should be judged in the light of all aspects and not just cost-based budgets alone.

I have reviewed only the major points of our program but I believe this report gives an idea of its scope and

complexity. There are several unresolved problems which require policy determination. In order to expedite the preparation of the details that are involved, I have scheduled a series of policy planning meetings as indicated on the attached list.

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Deputy Comptroller